COMMONWEALTH OF MASSACHUSETTS

APPELLATE TAX BOARD

KENNAMETAL, INC.
V.
COMMISSIONER OF REVENUE

Docket Nos. 170029, 183527, 186703
Promulgated: November 1, 1996

These appeals under the formal procedure pursuant to G.L. c. 62C, § 39, as amended, from the refusal of the appellee to abate corporate excise taxes assessed under G.L. c. 63, § 38.

Commissioner Scharaffa heard the appeals and was joined in the decision for the appellee by Commissioners O'Brien and Wall.

These findings of fact and report are made pursuant to a request by the appellant under G.L. c. 58A, § 13, as amended, and 831 CMR 1.32.

William E.Halmkin, Esq., and *Donald W. Parker*, Esq., for the appellant.

Edward J. Liptak, Esq., and *Philip S. Olsen*, Esq., for the appellee.

FINDINGS OF FACT AND REPORT

Introduction

On the basis of the parties' Agreed Statement of Facts, testimony, and exhibits, the Board made the following findings of fact.

Kennametal, Inc. ("Kennametal") is a multi-national corporation organized under the laws of Pennsylvania with a principal place of business at Route 981 South, Latrobe, Pennsylvania. Kennametal is engaged in the development, manufacture, marketing and application of cemented carbides, ceramics and other materials used in machining, cutting, shaping and forming of alloys, pure metals, coal, concrete and other substances.

On August 20, 1943, Kennametal registered with the Secretary of State's Office to do business in the Commonwealth of Massachusetts. From November 1, 1943 through March 31, 1960, Kennametal maintained a customer service center in Springfield, Massachusetts. Since April 1, 1960, Kennametal has not owned or rented office space within the Commonwealth.

As a foreign corporation, Kennametal filed Form 355B and paid the tax due as shown on its returns for each tax year from 1943 until 1963. On January 17, 1963, Kennametal filed Form 355F, Statement of Facts Relative to Business, seeking permission to discontinue filing Massachusetts foreign corporation excise returns.

On or about February 13, 1963, the Commissioner of Revenue ("Commissioner") responded to Kennametal's request and indicated that Kennametal was not subject to excise under Chapter 63 of the Massachusetts General Laws.

In March 1984, the Commissioner issued a Letter Ruling indicating that use of company cars within the Commonwealth was sufficient to establish nexus for purposes of imposing the corporate excise tax.

Jurisdiction

Kennametal timely filed its corporate excise returns for tax periods beginning July 1, 1984 and ending August 30, 1989. Kennametal also timely filed, in response to the Commissioner's audit, all tax returns for tax periods beginning July 1, 1975, and ending August 30, 1984. Kennametal timely filed all Applications for Abatements, and Formal Petitions with the Board, for tax periods beginning July 1, 1975 and ending August 30, 1989. Based on the foregoing, the Board finds that it has jurisdiction over the subject appeals.

Activities

The primary products sold by Kennametal are cutting bits which are mounted into various types of machine tools for the purpose of cutting and shaping a metal workpiece. In most machining operations, the metal workpiece which is to be cut is rotated at different angles against the stationary cutting tool. Metal cutting tools have short lives of anywhere from several minutes to a day. Choosing the proper cutting

tool for a particular application is essential to purchaser satisfaction and Kennametal's overall profitability.

Kennametal's business activities in Massachusetts for the years in question included sales to Massachusetts customers through a direct field sales force. Kennametal's sales force was comprised of Tooling Systems Engineers ("TSEs"), assisted by Service Engineers ("SEs") and Engineered Productivity Personnel ("EP"), all of whom either lived in or traveled to Massachusetts. The record is not clear as to exactly how many employees Kennametal had in Massachusetts in any one given year, but the record supports the conclusion, and the Board finds, that there were at least 4 TSEs and 7 SEs visiting hundreds of clients located within the Commonwealth at all relevant times.

The TSE's primary responsibility was management of the total sales and promotional efforts for the complete line of Kennametal metalworking products within a prescribed geographic area. Pursuant to Kennametal's field sales manual, SEs were entry level trainees whose primary responsibility was to assist the TSE in increasing and maximizing sales volume and customer satisfaction. SEs had no direct account responsibility, and did very little, if any order taking, but would travel with the TSE and perform what Kennametal has termed "sales-related" functions. The field personnel would visit existing and prospective customers on a regular basis.

Kennametal's products are highly sophisticated and technical. The products could not simply be installed and be expected to operate at peak efficiency without technical advice and assistance. As such, the TSE and SE would often perform the following functions, among others:

1) Coordinate and present "Training Programs"/In-Plant Presentations;
2) Provide samples of a particular tool so that customers could do test runs;
3) Coordinate a "Standardization Program," including inventory analysis and performance tests at customers' facilities;
4) Assist customers' engineering staff in custom-designing machine cutting tools;
5) Assist customers' in properly applying a cutting tool; and,
6) Report customers' complaints and/or unresolved problems.

Due to the highly technical nature of Kennametal products, Kennametal believed it was necessary to provide customers with detailed technical information so that they could assess the value of Kennametal products. In addition, many of Kennametal's customers changed markets on a regular basis, requiring a new approach to grades, tooling and machining processes.

Throughout the years in question, Kennametal's customers were under a great deal of pressure, due to foreign competition and inflation, to control their operating costs and improve productivity. Kennametal recognized the high cost of their products, in comparison to their competitors, and undertook a number of programs to demonstrate to their customers why their products were superior.

These programs were not only limited to new customers, but would also be performed on behalf of existing customers, in an attempt to maximize customer satisfaction and to potentially expand Kennametal's market share. For example, Kennametal had their field personnel conduct tooling-product-application studies, called "Tool Performance Reports," on behalf of their customers, to demonstrate to their customers the superiority of Kennametal products.

These studies involved the application of Kennametal products in actual work situations at a customer's plant. During the test-run, the TSE or SE would note the parameters of operation. Although the Kennametal employee in charge of the study would not actually run the machine, due to liability concerns, he or she would be present at the customer's plant to advise the operators on how to properly use the Kennametal products and what parameters should be applied.

As the product was in use, the SE would make recommendations to the customer's employees concerning, among other technical suggestions, different parameters to be used which could affect the machining process. Upon completion of the study, the results obtained from using a Kennametal product would be compared to those obtained in using a competitor's product. Results from one Kennametal product would also be compared to the results of another Kennametal product of a different grade. The ultimate goal of the study was "to determine the cost effectiveness of given machining operations" and to reduce a customer's overall machining costs.

Kennametal sought to have their customers place "blanket orders," which reflected a customer's estimated annual usage of a particular Kennametal product. Kennametal would set aside inventory to satisfy this "blanket order." During the course of the year, the customer would place "releases or individual purchases" so as to release the product from Kennametal's inventory to the customer. At times, after the "blanket order" had been placed, the Kennametal employee would conduct another tool performance report to demonstrate that there was in fact an economic justification for purchasing Kennametal products and that the customer was getting the results it anticipated. In the instances where the tool performance report indicated that the Kennametal product was not the better choice, the Kennametal employee would work with the customer's employee in suggesting different parameters so as to improve the output of the Kennametal product.

Another mechanism for convincing customers of the superiority of Kennametal products was the "Tool Standardization/Consultative Program." This program involved two phases. The first phase was referred to as the "survey." The survey required the TSE to gain access to the customer's "floor" and gather information about the customer's current inventory. In many cases, the customer did not have a complete compilation of its inventory, and thus the process could be very time consuming, lasting anywhere from a few hours to several days. The information obtained would then allow the TSE to determine exactly what competitor products the customer had, and to recommend different styles and sizes of Kennametal products. After analyzing all of this information, the TSE would make

specific recommendations of items which the customer could purchase from Kennametal.

The second phase of the "Tool Standardization/ Consultative Program" was called the "implementation." The implementation would begin after the customer determined that it would be cost effective to transfer to a complete line of Kennametal products. In this phase, the customer would place a "blanket order," locking into a set price for a particular tool or set of tooling products for a specific machine. The items would remain in Kennametal's Connecticut warehouse until the customer called them down for delivery. After the customer called down a small amount, either the TSE or the SE would observe a head-to-head demonstration of a Kennametal product and the competitor's product.

This demonstration would then allow the TSE or SE to complete a Tool Performance Report. This report was then used to show the purchaser that the Kennametal product did in fact out-perform the competitor's product. If, however, the tool did not measure up to the Tool Standardization Report, the SE and/or TSE would assist the machine operator by suggesting certain changes to the applications, allowing the Kennametal tool to perform at peak efficiency. To quote Keith Lamontagne, employed by Kennametal for 13 years, as both a TSE and an SE, "We certainly prefer the customer do that [work with the Kennametal employee] rather than risk losing that insert business to someone else."

Another program offered to Kennametal customers were "in-plant presentations." These presentations ranged

anywhere from two to six hours in duration, and attendance ranged from as low as eight people to as many as two hundred. Presentations were given to employees of potential as well as current customers. The subject matter of the sessions typically involved an overview of basic machining practices and techniques, as well as the proper use and application of Kennametal products. Kennametal strove to have each TSE conduct at least one such program per month.

Throughout their many visits to a customer's plant, Kennametal sales staff would often speak directly with the technical staff, in addition to the individual in charge of purchasing, allowing them to assess specific needs. Through these discussions the TSE would, at times, help a customer design a particular tooling system around the capabilities of Kennametal products. In addition, the sales force would often find themselves giving advice concerning set-up of a particular Kennametal product.

Lastly, field personnel were also responsible for responding to and resolving customer complaints. When a customer had a problem with a product it purchased from Kennametal, the TSE or the SE was there to correct it. Kennametal was well aware of the high cost of its product. As such, they acknowledged the importance of having a local representative who could quickly and efficiently respond to the problems and concerns of customers.

The activities performed by both the TSEs and the SEs were not limited to only potential customers. In many situations, the in-plant training programs, as well as providing technical advice and problem shooting, were provided to existing customers. Although Kennametal maintained that in

such cases, the sales force would be trying to increase sales and/or educate the customers about new products, its employees were also performing a function beyond mere "solicitation of orders." They were providing technical advice on the proper use of the product, and performing detailed studies of alternative products and procedures.

To the extent it is a finding of fact, the Board finds that the activities of Kennametal employees served an independent business function and were not entirely ancillary to the solicitation of orders. Although such technical advice and studies may help to increase purchases, they are not ancillary to requesting purchases since there is an independent business reason to provide advice on the proper use of its product regardless of whether Kennametal had a sales force. The fact that such activities were assigned to the sales force does not convert the activities into those entirely ancillary to solicitation. Accordingly, the Board issued a decision for the Commissioner of Revenue in these appeals.

OPINION

Massachusetts General Laws requires "every foreign corporation . . . qualified to do business or actually doing business in the Commonwealth, or owning or using any part or all of its capital . . . in the Commonwealth . . ." to pay a corporate excise. G.L. c. 63, § 39. The appellant in the present appeals neither owned nor rented any real property situated within the Commonwealth for the taxable years in question. As such, the issue to be determined is whether or not Kennametal was "doing business in the Commonwealth" thereby subjecting it to Massachusetts corporate excise tax.

The right to tax is an inherent power of sovereignty that must be found within the letter of the law and may not be implied. *Commissioner of Corporations and Taxation v. Tousant*, 309 Mass. 84, 85 (1941). A foreign corporation entering a state subjects itself to the jurisdiction of that state including its local tax laws. *Norton Company v. Department of Revenue of Illinois*, 340 U.S. 534, 537 (1950).

This inherent power to tax, however, is not without limit. Congress has prohibited the states from imposing taxes on income derived from "business activities" in interstate commerce which are limited to the "solicitation of orders." 15 U.S.C. § 381. Section 381, also known as Public Law 86-272 provides, in pertinent part:

(a) No state, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only *business activities* within such State by or on behalf of such person during such taxable year are either, or both of the following: (emphasis added)

1) the *solicitation of orders* by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside this State; and

2) the *solicitation of orders* by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if

> orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

15 U.S.C. § 381 (1988) (codifying § 101 of Pub. L. 86-273 [73 Stat. 555 (1959)]).

In 1994, the Massachusetts Supreme Judicial Court ruled that the mere "qualification to do business" was not enough to remove a corporation from the immunities of § 381. *Commissioner of Revenue v. The Kelly-Springfield Tire Company,* 419 Mass. 262 (1994). The Court did not entertain the issues presented in this appeal of what activities are encompassed within the term "solicitation of orders" and when has a corporation's activities exceeded those protected by § 381.

While § 381 was designed to define a lower limit for the exercise of a state's power to tax (*Heublein, Inc.*, 409 U.S. 277, 280 (1972)), the statute does not define what is encompassed within "solicitation of orders." As a result, states have been left to determine, on a case-by-case basis, whether the activities of a particular corporation exceed "solicitation of sales." As might be expected, there has been a split between those states which have interpreted "solicitation of orders" narrowly and those which have allowed an expanded interpretation.

In 1970, the New Jersey Superior Court decided the case of *Clairol, Inc. v. Kingsley,* 109 N.J. Super 22; 262 A.2d 213 (1970). In that case, the court observed that Clairol employed "detailmen and other representatives" to visit retail drugstores "to promote the public's purchase and use of its

products." *Id.* at 29. As part of their duties, the detailmen would occasionally review the display of Clairol products and assist the retailer in rearranging the display. In addition, with the retailer's permission, the detailman would take an inventory of the store's stock of Clairol products, would discuss the inventory with the retailer, and from there would write up a suggested order.

Besides the detailmen, Clairol also employed representatives who called on beauty salons. Like Kennametal's SEs, the representatives who called on the beauty salons had a technical background and would do very little order taking. A major part of their function was going into the local beauty salons to instruct the staff on how to use Clairol products. The Court rejected Clairol's argument that the term "solicitation of orders" should be interpreted to include all of their activities within the state. Even though the Court acknowledged that the activities of Clairol's representatives would promote purchase of Clairol products:

> That increased public favor of Clairol's products will eventually result in increased orders from retail druggists to wholesalers and from wholesalers to Clairol, or as in the case of its hair products from beauty salons to "beauty jobbers" and from the latter to Clairol, does not blanket all Clairol's activities with the protection afforded by the federal act to cases where the only business activity of the taxpayer is the solicitation of orders.

Id. The Court concluded that the activities of Clairol exceeded the "solicitation of orders" and therefore they were exempt from the immunities of § 381. Application of the

analysis used by the Clairol Court would result in a ruling in this appeal that the activities of Kennametal field personnel, primarily the providing of technical assistance and guidance as to how to use a particular product, went beyond "solicitation of orders."

The Oregon Supreme Court had the opportunity to address "solicitation of orders" in *Miles Laboratories, Inc. v. Department of Revenue*, 274 Or. 395, 546 P.2d 1081 (1976). The issue in *Miles Laboratories,* was whether or not Miles Laboratories had sufficient activities in Washington to subject them to taxation in that state. The plaintiff marketed proprietary medicines, nutritional and hygienic products and pharmaceuticals through distribution warehouses.

The company employed salesmen in the state of Washington. Each salesman maintained a stock of samples sufficient for a calendar quarter. These samples would be used for "account presentations," "samples for account personnel," "exchanging damaged merchandise," and "personal family samples." The Court concluded that the salesmen's activity of replacing damaged merchandise exceeded "solicitation" thereby giving Washington the power and jurisdiction to tax Miles Laboratories. *Id.* at 397, 546 P.2d at 1082.

In its decision, the Miles Laboratories Court adopted the reasoning of the Tax Court in *Olympia Brewing v. Dept. of Rev.*, 266 Or. 309, 511 P.2d 837 (1973), *cert. denied, 415* U.S. 976, 94 S.Ct. 1561 (1974), that:

> " ... 'solicitation' should be limited to those generally accepted or customary acts in the industry which lead

> to the placing of orders, not those which follow as a natural result of the transaction, such as collections, servicing complaints, *technical assistance and training...*"

Miles at 399, 546 P.2d at 1082 (emphasis supplied). Since much of the activities of Kennametal's TSEs and SEs involved technical assistance and training, the *Miles Laboratories* and *Olympia Brewing* decisions also suggest that Kennametal's activities exceed mere solicitation.

In *National Tires, Inc. v. Lindley*, 68 Ohio App.2d 71, 426 N.E.2d 793 (1980), appellant's business activities in Ohio "involved 'something more than solicitation.'" *Id.* at 79. National Tires sold "Modac" brand automotive parts to NAPA distribution centers in Ohio, through two levels: a zone manager and district managers. The district manager's function was to "call upon and give service to distribution centers, "jobbers," and "dealers." *Id.* at 74. The district and zone managers constantly checked inventory levels and records, removed old, defective products and ensured proper credit for them, replaced worn packaging, advised retailers on methods to improve their inventory, and checked to "see if there [were] any particular problems [he or she] can handle right now." *Id.* 74-75. In short, the court ruled that "[a]ppellant's zone and district managers performed functions more commonly related to maintaining an on-going business operation." *Id.* at 78-79.

Through their Standardization Program, Kennametal field personnel helped the purchaser, in some instances, by creating an inventory of products or bringing an existing inventory up to date. This information would then be used

to suggest potential items for purchase. As stated by Kennametal employees, this program was primarily designed to justify the high cost of Kennametal products and prove the cost effectiveness of switching to a full line of Kennametal products. Similar to the facts in *National Tires*, Kennametal's personnel were "maintaining an on-going business operation," venturing into business decisions with which a salesman would not normally be involved.

At the opposite end of the spectrum are the cases which apply a broad interpretation of "solicitation of orders" so as to include more activities within the protection offered by § 381. In *Gillette Company v. State Tax Commission*, 56 A.D.2d 475, 393 N.Y.S.2d 186 (3d Dep't 1977) *aff'd* 45 N.Y.2d 846 (1978), the New York Court of Appeals concluded that advising on display techniques did not go beyond those activities protected by § 381. *Id.* at 191. The Court concluded that where, "the taxpayer owns no real or personal property ... in the State and *makes no repairs on its goods after sales*, the purpose of P.L. 86-272 would be frustrated by permitting the tax." *Id.* (emphasis added).

Gillette, however, can be distinguished from the present appeal. Although Kennametal did not make physical repairs after the sale, by providing technical assistance as to the proper application of the product after the sale, and completing tool performance reports and tool standardization programs in which Kennametal employees suggested operational and/or product changes, Kennametal's activities are akin to post-sale "repairs."

In *Indiana Dept. of Revenue v. Kimberly-Clark Corp.*, 375 N.E.2d 1146 (Ind. Ct. App. 1978) *(Kimberly-Clark 1)*,

salesmen operating in Indiana would discuss with their direct customers ways to increase sales of the Kimberly Clark products. Occasionally, the salesmen called on indirect customers and did "missionary work" which included checking inventories, checking shelf facings and explaining products.

The Indiana Appeals Court agreed with the Supreme Court of Oregon that "'solicitation' must be limited to the acts which lead to the placing of an order." *Kimberly-Clark I* at 1149. The court concluded that checking customer inventories, pricing products and stocking shelves, and erecting displays may "reasonably be regarded as activities leading to the placing of orders..." *Id.* at 1150. However, the court concluded that conveying information to customers concerning out-of-stock conditions or delays in shipments, verifying destruction of damaged merchandise, and coordinating delivery of merchandise for special promotions could not be classified as "solicitation." *Id.*

On further appeal, the Indiana Supreme Court concluded that Kimberly-Clark's activities did not exceed those protected by § 381. *Indiana Department of Revenue v. Kimberly-Clark Corporation*, 416 N.E.2d 1264. The Indiana Supreme Court focused on those functions which the Appeals Court deemed not to be solicitation. In their decision, the court concluded that "Congress perceived 'solicitation' as embodying 'sundry activities so long as those activities [are] closely related to the eventual sale of a product.'" *Id.* at 1268.

It was not until 1992 that the United States Supreme Court decided the case of *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 112 S.Ct. 2447 (1992). Wrigley was

the Court's first statement as to what was encompassed by the term "solicitation of orders," and thus provided the first guidance as to what activities were protected under § 381.

The Wrigley Court concluded that the term "solicitation of sales" should not be construed as narrowly as suggested by *Clairol*, *Miles Laboratories*, and *National Tires*, so that only "actual requests for purchases or, at most, the actions absolutely essential to making those requests" were protected. *Wrigley* at 2455. The Court ruled that limiting the protected activities to the "actual request for purchases would reduce § 381 to a nullity" and limiting it to acts "essential for making requests would engender endless uncertainty." *Id.* at 2455.

The Court also, however, declined to broadly interpret, as suggested in *Gillette* and *Kimberly-Clark*, the term "solicitation of sales," rejecting the "'routinely-associated-with-solicitation' or 'customarily-performed-by-salesmen' approach." *Id.* Such an interpretation would render the limitations of § 381 "toothless." *Id.* at 2456.

In describing the proper standard to be applied, the Court also rejected the pre-sale/post-sale distinction. *Id.* at 2457. Acknowledging that "solicitation of orders" entails more than what is strictly *essential* to the requesting of purchases, the Court concluded that the next clear line must be drawn between "those activities that are entirely ancillary to requests for purchases - those that serve no independent business function apart from their connection to the soliciting of orders - and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force." *Id.* at 2456 (emphasis added) *citing National*

Tires, Inc. v. Lindley, 68 Ohio App.2d 71, 78-79, 22 Ohio Op. 3d 69, 73-74, 426 N.E.2d 793, 798 (1980) (company's activities went beyond solicitation to "functions more commonly related to maintaining an on-going business").

The Court in *Wrigley* specifically stated that employing salesmen to repair or service the company's products is not part of the "solicitation of orders." "Repair and servicing may help to increase purchases; but it is not ancillary to *requesting purchases*, and cannot be converted into *'solicitation' by merely being assigned to salesmen.*" *Wrigley* at 2457 (emphasis added). This was the only particular activity which the Court stated would remove a company from the immunity provided by § 381.

In its analysis, however, the Court cited the *Clairol* case. Although the Court noted that it did not agree with the New Jersey Court's application of a narrow interpretation of "solicitation of orders," the Court did agree with the ultimate decision based on the facts of the case. The Court reasoned that even applying a broad interpretation of "solicitation," "sending non-sales representatives to provide customers technical assistance in the use of Clairol products" would have resulted in the same judgment. *Wrigley* at 186, n.2.

In the present appeals, Kennametal's employees typically offered technical assistance to the customer's machinists both on an individual basis and through group presentations. Due to the highly technical nature of the Kennametal products, TSEs customarily offered "in-plant training programs." The subject matter of the sessions typically concerned the proper use and application of Kennametal products, as well as an overview of basic

machining practices and techniques. TSEs would also speak directly with the customer's employees to discuss problems with a particular product.

More in line with *Clairol* is the fact that SEs who admittedly had "no direct sales accounts" quite regularly, as part of their functions, offered technical assistance to a customer's employees as to the proper application and usage of Kennametal's products.

In conclusion, the Board ruled that Kennametal's activities within the Commonwealth, including inventory analysis and recommendations, product application studies; performance testing, providing technical assistance and guidance, and conducting in-plant training programs, exceeded "solicitation of orders." The Board also ruled that these activities, when taken as a whole, were not *de minimis*. Although Kennametal's activities may have had the effect of helping to enhance future sales and ultimately increase its market share, they were not *entirely ancillary* to the solicitation of orders. The activities obviously ingratiated the salesmen, but quite clearly had an "independent business function."

Kennametal urges, in the alternative, that even if any one particular function exceeds "solicitation of orders," there is a *de minimis* standard adopted in *Wrigley*. Although this may be accurate, the Court in *Wrigley* states that the proper inquiry is to look at the sum of all activities and not at individual activities in isolation.

The TSEs aimed to perform at least one in-plant training program per month. When conducting a

Standardization Program, the SE or TSE would be occupied anywhere from several hours to several days for one particular customer. Kennametal had many hundreds of clients situated within the Commonwealth. All of these customers had TSEs and SEs who visited them on a regular and frequent visit. During any one of these visits, the field personnel would offer technical assistance.

On this basis, the Board concludes that, taken as a whole, Kennametal's activities exceed any which would be allowed applying a *de minimis* standard.

Kennametal also suggests that the sales factor, used in determining Massachusetts taxable income, was miscalculated by the Commissioner. The party seeking an abatement generally has the burden of proof. *State Tax Comm'n. v. Hohn H. Breck, Inc.* 336 Mass. 277, 289 (1957); *A. W. Chesteron Company v. Commissioner of Rev.*, 37 Mass. App. Ct. 936 (1994); *Blakely v. Commissioner of Rev.*, 28 Mass. App. Ct. 499, 501 (1990). Thus, Kennametal bore the burden of proving that sales from the Canadian branch were inappropriately excluded from the denominator of the sales factor. Kennametal offered no evidence at trial on this point, nor did it offer more than a passing remark in any of its numerous briefs.

Based on the foregoing this Board concludes that Kennametal's activities within the Commonwealth exceeded the "solicitation of orders" protected by 15 U.S.C. § 381, and therefore was subject to the Massachusetts corporate excise tax for the years in question. In addition, Kennametal has failed to meet its burden of proof regarding the

Commissioner's determination of Massachusetts taxable income.

The decision for the appellee was promulgated on November 8, 1995.

APPELLATE TAX BOARD

/s/ Kenneth W. Gurge, Chairman

SJC-07448

KENNAMETAL, INC. *vs.* COMMISSIONER OF REVENUE.

Suffolk. September 5, 1997. - October 29, 1997.

Present: Wilkins, C.J., Abrams, Lynch, Greaney, Fried, Marshall, & Ireland, JJ.

Taxation, Corporate excise, Excise, Corporation. *Administrative Law*, Substantial evidence.

Appeal from a decision of the Appellate Tax Board.

The Supreme Judicial Court granted an application for direct appellate review.

William E. Halmkin (*Donald W. Parker* with him) for the plaintiff.

Thomas A. Barnico, Assistant Attorney General, for the defendant.

IRELAND, J. We granted an application from the Commissioner of Revenue (commissioner) for direct appellate review on this appeal by Kennametal, Inc. (Kennametal),

from a decision of the Appellate Tax Board (board). The board ruled that Kennametal, a Pennsylvania corporation, conducted activities within the Commonwealth between 1979 and 1989 that exceeded those protected by Pub. L. 86-272, codified at 15 U.S.C. § 381 (1994), thus subjecting Kennametal for those years to the Massachusetts excise on foreign corporations provided in G.L. c. 63, § 39. We affirm the board's decision.

1. *Background.*

Kennametal is a multinational corporation, organized under the laws of Pennsylvania and headquartered in that Commonwealth. Kennametal is engaged in the development, manufacture, and sale of cutting bits[1] and related products for the machining of metals, alloys, and plastics. The total product line consists of approximately 20,000 types of cutting bits and accessories.

Kennametal has been registered to do business in Massachusetts since 1943. During the ten-year period in question, from 1979 to 1989, Kennametal conducted business

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[1] Cutting bits are small pieces of tungsten carbide. The bit is inserted into a tool holder which is then inserted into a larger machine tool. In most machining operations, the piece to be cut or shaped is rotated at different angles and at high speeds against the stationary cutting bit. The life of the cutting bit depends on such factors as the type of material and speed of rotation of the piece being machined, the angle of the cut, the shape of the cutting bit, and the age and condition of the machine tool itself. The cutting bit's life typically ranges from a few minutes to no more than a day.

in Massachusetts through the use of a direct field sales force. The sales force consisted primarily of tooling systems engineers (TSEs) and service engineers (SEs). TSEs were experienced personnel responsible for maintaining customer accounts. TSEs regularly visited current and prospective customers to solicit orders, conduct presentations, and give technical advice. SEs were less experienced personnel who did not have responsibility for customer accounts and whose primary function was to assist the TSEs. During the period in question, Kennametal held no property in Massachusetts other than its sales catalogs, automobiles that it leased for use by its sales force, and samples of cutting bits which the sales force used in connection with customer visits.

Kennametal paid the Massachusetts corporate excise for the tax years 1943 through 1963. In 1963, the commissioner ruled that Kennametal's activities in the Commonwealth at that time did not subject it to the corporate excise. Accordingly, Kennametal ceased filing corporate excise returns in Massachusetts.

In March, 1984, the commissioner issued a letter ruling holding that the use of company cars within the Commonwealth by employees of a foreign corporation constituted a level of business activity sufficient to subject the corporation to the Massachusetts excise.[2] Consequently, Kennametal resumed filing Massachusetts corporate excise returns for the 1985 tax year and timely filed corporate excise returns thereafter for each tax year over the remainder of the

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[2] *See* LR 84-1, revoked by LR 88-7, 3 Mass Tax Guide at 567, 615 (West 1997).

period in question. In 1987, the commissioner commenced an audit of Kennametal that resulted in the assessment of additional taxes and penalties for the tax years 1976 through 1984. Kennametal timely filed requests for abatement for all relevant tax years. The commissioner abated penalties for the tax years 1976 through 1985, but denied the remainder of the abatement requests. Kennametal appealed to the board, which affirmed the commissioner's determination.

2. *Discussion.*

General Laws c. 63, § 39, imposes an excise on "every foreign corporation . . . actually doing business in the commonwealth . . . in a corporate form." The Commonwealth's broad taxing authority over foreign corporations, however, is limited by the Federal government's plenary power to regulate interstate commerce pursuant to the commerce clause of the United States Constitution. Acting under its constitutional powers, Congress in 1959 enacted Pub. L. 86-272, which expressly restricts the authority of a State to impose an income tax on foreign corporations whose business within the State consists solely of "the solicitation of orders . . . for sales of tangible personal property, which orders are [then] sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State."

Public Law 86-272 does not define "solicitation of orders." A number of State courts have attempted to define

this term more precisely.[3] However, there was no Federal case law dealing directly with this definition prior to 1992.[4] In that year, the United States Supreme Court in *Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214 (1992) (*Wrigley*), concluded that solicitation of orders "covers more than what is strictly *essential* to making requests for purchases" (emphasis in original) *Id.* at 228. As such, some activities within the State involve something more than a direct request for purchase but, nevertheless, are still protected from State taxation under Pub. L. 86-272.[5]

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[3] See, e.g., *Hervey v. AMMMF Beaird, Inc.*, 250 Ark. 1971); *Coors Porcelain Co. v. State*, 183 Colo. 325 (1973), *cert. denied*, 419 U.S. 874 (1974); *Indiana Dep't of Revenue v. Kimberly-Clark Corp.*, 275 Ind. 378 (1981); *Indiana Dep't of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754 (Ind. Ct. App. 1980); *Clairol, Inc. v. Kingsley*, 109 N.J. Super. 22 *aff'd*, 57 N.J. 199 (1970), *appeal dismissed*, 402 U.S. 902 (1971); *Gillette Co. v. State Tax Comm'n*, 56 A.D.2d 475 (N.Y. 1977); *aff'd*, 45 N.Y.2d 846 (1978); *National Tires, Inc. v. Lindley*, 68 Ohio App. 2d 71 (1980); *Miles Lab., Inc. v. Department of Revenue*, 274 Or. 395 (1976); *Iron Fireman Mfg. Co. v. State Tax Comm'r*, 251 Or. 227 (1968).

[4] In *Heublein, Inc. v. South Carolina Tax Comm'n*, 409 U.S. 275, 278-282 (1972), the United States Supreme Court reviewed the history of Pub. L. 86-272. However, the Court stated that it did not need to decide "whether . . . the actions of Heublein's representative . . . [fell] within the term 'solicitation'" and thus did not define the term. *Id.* at 278.

[5] *Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 231-232 (1992), also held that Pub. L. 86-272 could protect an activity from State taxation if the activity qualified under a *de*

(continued...)

However, *Wrigley* drew a "clear line . . . between those activities that are entirely ancillary to requests for purchases – those that serve no independent business function apart from their connection to the solicitating of orders – and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force" (emphasis in original). *Id.* at 228-229. Hence, the solicitation of orders may include the provision of an automobile and a stock of free samples to a salesman, as these activities serve no purpose other than "to facilitate requests for purchases." *Id.* at 229. By contrast, the Court stated that:

> "employing salesmen to repair or service the company's products is not part of the 'solicitation of orders,' since there is good reason to get that done whether or not the company has a sales force. Repair and servicing may help to increase purchases; but it is not ancillary to *requesting purchases*, and cannot be converted into 'solicitation' by merely being assigned to salesmen" (emphasis in original). *Id.*

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[5] (...continued)
minimis exception. To qualify for a *de minimis* exception, a court must consider the activities of the taxpayer within the State as a whole. *Id.* In *Wrigley*, the taxpayer's sales force made direct sales to customers amounting to 0.00007% of the taxpayer's total sales within the State. The Court stated that this activity exceeded the permissible scope of solicitation of orders and also did not qualify for the *de minimis* exception because of the sales force's other activities within the State. *Id.* at 235. Kennametal does not argue here that its activities qualify under the *de minimis* exception.

The *Wrigley* Court expressly rejected as overly broad the taxpayer's argument that "solicitation of orders" included any activities "routinely-associated-with" or "customarily-performed-by salesmen." *Id.* at 227.

Kennametal does not dispute that it "actually [does] business in the commonwealth" as set out in G.L. c. 63, § 39. Kennametal also does not dispute the dollar amount that is due if any amount is due at all. Rather, Kennametal claims that its activities within the Commonwealth during the tax years in question consisted solely of the solicitation of orders as described in Pub. L. 86-272, and that it is therefore not subject to the Massachusetts corporate excise at all.

A decision of the board will not be reversed or modified if it is based on a correct application of the law and if it is based on substantial evidence. *See Koch v. Commissioner of Revenue*, 416 Mass. 540, 555 (1993); *Commissioner of Revenue v. Wells Yachts South, Inc.*, 406 Mass. 661, 663 (1990) ; *Tenneco Inc. v. Commissioner of Revenue*, 401 Mass. 380, 383 (1987). The board's decision is final as to findings of fact.[6] G.L. c. 58A, § 13. But the court may consider whether the evidence in the case is sufficient to support the board's conclusion of law. *Assessors of Weymouth v. Curtis*, 375 Mass. 493, 499 (1978); *Boston Edison Co. v. Selectmen of Concord*, 355 Mass. 79, 92 (1968). Our review of the sufficiency of evidence, however, is limited to "whether

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[6] "The credibility of witnesses, the weight of the evidence, and inferences to be drawn from the evidence are matters for the board." *Cummington School of the Arts, Inc. v. Assessors of Cummington*, 373 Mass. 597, 605 (1977).

a contrary conclusion is not merely a possible but a necessary inference from the findings." *Commissioner of Revenue v. Houghton Mifflin Co.*, 423 Mass. 42, 43 (1996), quoting *First Data Corp. v. State Tax Comm'n*, 371 Mass. 444, 446 (1976).

We conclude first that the Board applied the correct legal standard. The board stated that:

> "the activities of Kennametal employees served an independent business function and were not entirely ancillary to the solicitation of orders. Although such [activities] may help to increase purchases, they are not ancillary to requesting purchases since there is an independent business reason to provide advice on the proper use of its product regardless of whether Kennametal had a sales force. The fact that such activities were assigned to the sales force does not convert the activities into those entirely ancillary to solicitation."

The board's exposition of the legal standard it used in reaching its decision comes directly from *Wrigley, supra* at 228-229, almost to the extent of direct quotation.

Kennametal's argument here focuses on what it refers to as the board's "reliance" on *Clairol, Inc. v. Kingsley*, 109 N.J. Super. 22, aff'd, 57 N.J. 199 (1970), appeal dismissed, 402 U.S. 902 (1971), decided twenty-one years before the *Wrigley* case. In *Clairol*, the court held that the taxpayer's activities within the State exceeded those protected by Pub. L. 86-272, thus subjecting the taxpayer to the state's corporate income tax. *Id.* at 30. The *Wrigley* Court, supra at 224-226, expressly rejected the analysis used in *Clairol*. However, the Court

concluded that the result in Clairol would remain unchanged even under the Wrigley analysis. *Id.* at 224 n.2. Here, the board used the *Clairol* result as one of a series of cases it analyzed to determine the permissible scope of "solicitation of orders." Nowhere does the board's reference to *Clairol* implicate a standard of legal review. Accordingly, the board's use of *Clairol* is appropriate, and Kennametal's argument that the Board relied on Clairol as an incorrect legal standard is without merit.[7] The board's decision is also supported by

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[7] Kennametal also argues that the legal standard for determining the scope of permissible activities was determined by the Appeals Court in *A. W. Chesterton Co. v. Commissioner of Revenue*, 37 Mass. App. Ct. 936 (1994). In *Chesterton*, the board determined that the out-of-State activities of the sales force of a domestic corporation (Chesterton) were entirely ancillary to the solicitation of orders and thus fell under the protection of Pub. L. 86-272 in the foreign States. The Appeals Court affirmed the Board. The Appeals Court stated that the out-of-State activities of the sales force included "handling consumer complaints and providing consumer and distributor training in the field." *Id.* at 938. Kennametal cites this language as standing for the proposition that the Appeals Court determined that such activities were within the permissible scope of solicitation of orders. However, the case is inapposite. The issue in this part of the Appeals Court's decision did not concern the standard for solicitation of orders, but rather the burden of proof. The Appeals Court simply held that Chesterton had not met its burden of proving that the activities of the sales force did in fact exceed the permissible scope of solicitation of orders because Chesterton's proof was "suggested only vaguely by the evidence it presented." *Id.* As such, the Appeals Court did not rule on the

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substantial evidence. The Administrative Procedure Act defines "[s]ubstantial evidence" as "such evidence as a reasonable mind might accept as adequate to support a conclusion." G.L. c. 30A, § 1 (6). According to the board, a number of Kennametal's activities within the Commonwealth exceeded the permissible scope of the solicitation of orders under Pub. L. 86-272. Those activities included (1) using samples for testing the performance of Kennametal's products and preparing reports based on the test results, (2) preparing inventory analyses as part of a broader tool standardization program,[8] and (3) making frequent in-plant presentations (up to six hours in length and involving as many as 200 employees of current and prospective customers) on the use of Kennametal's products.

There exists no bright line to distinguish those activities that are entirely ancillary to the solicitation of orders from those that also serve an independent business function. *See Wrigley*, *supra* at 228-29. Activities such as those cited by the board occur along a continuum. *Wrigley* guides our analysis merely with examples at each end of that continuum. In the end, business activities conducted within a State must be considered on an individual basis.

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[7] (...continued)
merits of the permissible scope of solicitation of orders and Kennametal's reading of *Chesterton* is incorrect.

[8] The tool standardization program involved surveying every machine at a customer's plant and preparing an analysis of how Kennametal's products could be used exclusively for each machine. The surveys lasted from a few hours to several days.

The activities here in question were designed not only to solicit orders, but to ingratiate customers and to assist buyers in knowing what to order. Those activities fall outside of the protection afforded by Pub. L. 86-272. Under *Wrigley*, the activities must facilitate the actual solicitation of orders; they may not merely serve to increase general sales. *Id.* at 233.

Kennametal had reasons independent of soliciting orders that motivated it to provide the activities in question, even if no sales force operated in the Commonwealth. For example, the proper use of Kennametal's products improves performance and enhances the company's reputation among buyers. This can be especially important for companies such as Kennametal that attempt to promote their products as being of higher quality than those of competitors. Similarly, such activities on the part of Kennametal's sales force could relieve Kennametal from having to produce lengthy and detailed product manuals for customers. In short, the activities in question cannot be viewed as entirely ancillary to requests for purchase, but rather as serving an independent business function as well.[9]

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[9] The Board also determined that Kennametal exceeded the permissible scope of the solicitation of orders under Pub. L. 86-272 with respect to resolving customer complaints. *Wrigley*, *supra* at 234-235, held that the resolution of customer complaints was entirely ancillary to the solicitation of orders and thus protected by Pub. L. 86-272. The case at hand is distinguishable. In *Wrigley*, the customer complaints in question involved credit disputes with the main office. The activities of the in-State sales force primarily involved acting as an intermediary between customers and the main

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As such, Kennametal is not protected under Pub. L. 86-272.

Kennametal's own interpretation of its activities as merely part of an order solicitation process stretches Pub. L. 86-272 too far. Indeed, it is difficult to imagine where Kennametal's interpretation draws the line on impermissible activities. The *Wrigley* Court, *supra* at 226, explicitly noted that broad, open-ended interpretations of Pub. L. 86-272 would reduce that law to a nullity.

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[9] (...continued)
office; the actual resolution of the problem did not come from the sales force itself. (Such disputes arose only two to three times a year within the entire State. *Id.* at 217). As such, the Court concluded that the mediation activities were entirely ancillary to the solicitation of orders because it was unlikely "that this mediating function . . . would have been performed by some other employee . . . if the on-location sales staff did not exist." *Id.* at 235. By contrast, Kennametal's customer disputes primarily involved problems with the use of the product itself. Kennametal's sales force typically called or visited the customer to resolve the problems directly. Also, these disputes arose far more frequently than the credit disputes in Wrigley. One Kennametal salesperson testified to having encountered approximately eighteen such incidents within the previous year among his customers alone. It thus appears highly likely that some employee would have performed the dispute resolution function in the absence of an in-State sales force. As such, the activity cannot be considered as entirely ancillary to the solicitation of orders; it simply represents the transfer of an impermissible activity to the sales force. As noted in *Wrigley*, such a transfer does not make the impermissible activity permissible. *Id.* at 229.

The board reasonably could conclude as it did that presentations in front of 200 employees were primarily intended, generally, to increase sales rather than directly to facilitate the solicitation of orders. Similarly, the board could reasonably conclude that lengthy surveys of all the machines in a particular customer's plant were intended primarily to increase over-all sales rather than merely to solicit orders. The board might have reached contrary conclusions, but such conclusions are not necessarily inferred from the facts. *See Commissioner of Revenue v. Houghton Mifflin Co.*, 423 Mass. 42, 43 (1996).

Finally, Kennametal warns of the potential chilling effect of the board's conclusion on companies like Kennametal whose products (or the applications of those products) are technically oriented. Kennametal maintains that the board's decision would prevent any foreign company with an in-State sales force from communicating to customers even the slightest technical information through its sales force, lest the Massachusetts corporate excise apply. Nothing in this opinion creates such a Draconian standard. Consistent with *Wrigley*, supra at 229, the standard merely prevents tax-generating activities from ceasing to be tax-generating simply because they are performed by an in-state sales force.

The board's decision is affirmed.

so ordered.

15 U.S.C. § 381 (1994)
(PUBLIC LAW 86-272)

§ 381. Imposition of net income tax

(a) Minimum standards

No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) **Domestic corporations; persons domiciled in or residents of a State**

The provisions of subsection (a) of this section shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to -

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) **Sales or solicitation of orders for sales by independent contractors**

For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

(d) **Definitions**

For purposes of this section -

(1) the term "independent contractor" means a commission agent, broker, or other

independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

MASSACHUSETTS GENERAL LAWS, CHAPTER 63, SECTION 39

63:39. Foreign corporations; tax rate.

Section 39. Except as otherwise provided herein, every foreign corporation, exercising its charter, or qualified to do business or actually doing business or actually doing business in the commonwealth, or owning or using any part or all of its capital, plant or any other property in the commonwealth, shall pay, on account of each taxable year, the excise provided in subsection (a) or (b) of this section, whichever is greater.

The excise levied herein is due and payable on any one or all of the following alternative incidents:

(1) The qualification to carry on or do business in this state or the actual doing of business within the commonwealth in a corporate form. The term "doing business" as used herein shall mean and include each and every act, power, right, privilege, or immunity exercised or enjoyed in the commonwealth, as an incident to or by virtue of the powers and privileges acquired by the nature of such organizations, as well as, the buying, selling or procuring of services or property.

(2) The exercising of a corporation's charter or the continuance of its charter within the commonwealth.

(3) The owning or using any part or all of its capital, plant or other property in the commonwealth in a corporate capacity.

It is the purpose of this section to require the payment of this excise to the commonwealth by foreign corporations for the enjoyment under the protection of the laws of the commonwealth, of the powers, rights, privileges and immunities derived by reason of the corporate form of existence and operation.

In the case of a corporation whose taxable year is a period of less than twelve calendar months, the portion of the amount determined under clause (1) of subsection (a) shall be multiplied by a fraction whose numerator is the number of months included in the taxable year and whose denominator is twelve.

(a) an amount equal to the sum of:

(1) Seven dollars per thousand upon the value of -

(i) its tangible property as determined to be taxable under paragraph 7 of section thirty if a tangible property corporation, or

(ii) its net worth as determined to be taxable under paragraph 9 of section thirty if an intangible property corporation; and

(2) Eight and thirty-three one hundredths per cent of its net income determined to be taxable in accordance with the provisions of this chapter.

(b) Four hundred dollars.

A foreign corporation shall not be subject to tax under this chapter if the foreign corporation is engaged in the business of selling tangible personal property and taxation of that foreign corporation under this chapter is precluded by the Constitution or laws of the United States, or would be so precluded except for the fact that the foreign corporation stored tangible personal property in a licensed public storage warehouse, provided, that no portion of any warehouse which is owned or leased by a consignor or consignee of the tangible personal property shall be deemed a licensed public warehouse.

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